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SUBJECT: EEB A/S SULLIVAN DISCUSSES FISCAL AND PEMEX REFORM
WITH MEXICAN FINANCE U/S WERNER AND AMCHAM

REF: A. MEXICO 4552

- [1](#)B. MEXICO 4282
- [1](#)C. MEXICO 4280
- [1](#)D. MEXICO 4236
- [1](#)E. MEXICO 4191
- [1](#)F. MEXICO 4151
- [1](#)G. MEXICO 4015
- [1](#)H. MEXICO 3246
- [1](#)I. MONTERREY 725

Classified By: Economic Officer Laura M. Lausier, REASONS 1.4(b) and 1.4(d)

Summary

[1](#)1. (C) In an August 29 meeting with Assistant Secretary for Economic, Energy and Business Affairs Daniel Sullivan, Under Secretary of Finance Alejandro Werner expressed confidence

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that changes to the proposed Mexican Single Rate Income Tax for businesses (CETU) would allow the tax to be creditable against U.S. income taxes. He then described other proposed congressional changes that would make the new regime more palatable to business. Werner noted that progress on intra-party negotiations has slowed as a result of PRI questions over gasoline taxes, as well as PRI insistence on changes to Pemex's tax regime. Despite these delays, Werner expected the overall reform to be completed within 3 weeks, adding that it would increase tax revenue by 2.4-2.5 percent of GDP versus the 3 percent originally proposed. A/S Sullivan also discussed the upcoming Major Economies Meeting on Climate Change, reported Septel. End Summary.

[1](#)2. (C) In an August 29 meeting with visiting A/S of State Dan Sullivan, Under Secretary of Finance Alejandro Werner (strictly protect) discussed negotiations and prospects for the tax reform proposal the Calderon administration floated

in June (see refs A-I). Werner said that negotiations have centered on a few key issues. The most significant changes to the government's proposal entail resolving issues regarding the CETU, the Single Rate Income Tax for businesses. The government proposal did not allow for the deductibility of wages, and there were issues regarding the CETU's creditability against U.S. income tax under the U.S.-Mexico tax treaty. Werner sounded confident that the creditability issue would be resolved. (Note: During a separate discussion with visiting U.S. Congressman Roy Blunt on August 21, Werner said negotiations with Treasury had led to Treasury's "understanding" the Mexican tax proposal, and that changes proposed during informal discussions with the Mexican Congress were making the CETU look more like U.S. corporate income tax, which would make it creditable against U.S. taxes. Werner said the tax, which is currently labeled a contribution -- thus CETU -- might end up being called a tax, or ITU (the Spanish word impuesto means tax) to emphasize its link to corporate income. End Note.)

13. (C) According to Werner, an additional significant change to the government's proposal is the introduction of a transition period from the old tax regime to the new system. Under the CETU, businesses cannot deduct interest on debt, which presents a problem for companies that invested a few years ago because they cannot deduct benefits accumulated under the old tax regime. To accommodate businesses who made investment decisions under the old regime, Werner said the GOM will calculate an "average tax credit" that can be credited to the new system.

14. (C) Werner said that the state tax on gasoline and diesel also has proved to be a stumbling block in negotiations. The PRI, which initially supported this tax, wavered because it came under fire in the run up to local elections in Veracruz. Werner said that the government was trying to negotiate this

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issue.

15. (C) The PRI's introduction of changes to Pemex' tax regime also has complicated negotiations. Since this tax regime was changed just a few years ago, Werner believes that the GOM should wait and see if more changes are needed. Werner added that if Mexico were to allow private sector participation in the energy sector, Pemex would require an entirely new tax system. First, he argued, Mexico should focus on making Pemex more efficient. Nonetheless, Werner said that since the PRI put this proposal on the table, the government would have to negotiate a feasible alternative.

16. (C) In response to a query from A/S Sullivan as to why the PRI introduced the Pemex proposal now, Werner responded that the party wanted to showcase a forward-leaning posture on economic reform. The new tax reform will increase government revenue, and the PRI wants to make sure that Pemex receives a part of this boon. According to Werner, since the PRI is supporting fiscal reform -- something that is clearly on the government's agenda -- it wanted to push some things on its own agenda (i.e., Pemex and electoral reform) for political cover.

17. (C) Werner believes that tax reform will be approved. He said that technical issues are not an obstacle at this point, and that the remaining steps are political in nature. If parties can find common ground, the reform could be approved as early the week of September 3. The issues discussed above have slowed the passage of fiscal reform, but Werner said the initiative could be approved within 3 weeks. He estimated that the reform would increase tax collection by 2.4-2.5 percent of GDP, versus the 3 percent envisioned in the government's initial proposal.

18. (C) Werner noted that the government's non-oil tax intake is only 10 percent of GDP, so Mexico will need to do more work down the road to reduce government dependence on oil

revenues, such as by fixing the value-added tax (VAT). He made reference to three prior unsuccessful attempts by former President Fox to address the VAT, and added that Calderon himself said that the VAT would not be addressed in the current reform proposal. Werner also mentioned the need to build a framework to make public spending more accountable.

¶9. (C) Werner said that the passage of tax reform would open the door for Calderon to pursue other economic objectives, including energy reform. He noted that telecommunications and energy reform were key components of increasing employment and competitiveness. Separately, Werner said he had heard that A/S Sullivan's meeting with Under Secretary for Communications Rafael del Villar went well (see septel).

American Chamber of Commerce

¶10. (SBU) At an August 30 AmCham breakfast with A/S Sullivan, a representative of a U.S. energy company emphasized the importance of opening up the energy sector to some form of private participation. He argued that while improving Pemex' efficiency was a laudable goal, it is impossible for one company to efficiently exploit all of Mexico's oil in the Gulf of Mexico.

¶11. (SBU) Chamber President Larry Rubin said Finance Minister Carstens had asked the Chamber to approach the IRS about creditability of the proposed corporate tax. Rubin reported Carstens had said that while Treasury now agreed the proposed new tax would be creditable, IRS lawyers were "holding out." A/S Sullivan promised to inquire in Washington.

¶12. (SBU) This telegram has been cleared with A/S Dan

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Sullivan.

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